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FOREIGN EXCHANGE DURING THE WAR

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One of the many difficult problems facing the belligerent nations in Europe during the past two years, certainly the most far-reaching one as far as the foreign commerce of the allied nations—England especially—is concerned, has been the supporting of the foreign exchange rate as near as possible to par, and if this was impracticable, at least near a certain level.

CONDITIONS AT THE BEGINNING OF THE WAR

In order to fully appreciate the importance of this consequence of an economic disturbance, which compelled the whole financial world to face new and untried conditions, it is necessary to go back to the beginning of the war. When, in the latter part of July, a settlement of Austrian demands on Servia proved futile and the spectre of a huge world war loomed threateningly on the European horizon, its influence was immediately reflected in the foreign exchange situation. It was a commonly known fact that America, at the outbreak of the war, was a debtor to Europe of about \$450,000,000. The city of New York, alone, owed \$80,000,000 in London and Paris which matured during the most critical period. Past experience has shown that our grain and cotton shipments in the fall largely offset such balances as may have been created against us during the summer months. The sudden withdrawal, however, of most ocean going vessels made the shipping situation so acute that some of the railroads had to put an embargo on export shipments; this, of course, was followed by a dearth of commercial bills in the market and caused a violent upward movement in demand sterling, which on July 21 stood at 4.8725, practically normal for that time of year. It rose by leaps and bounds in an unprecedented manner until on August 3 quotations of \$6.00 and \$7.00 per pound were not infrequent. Marks had risen to \$1.04 and francs were almost unobtainable, fcs. 3.25 being asked for on a dollar.

This unexpected phenomenal rise naturally worked great hardship on the importer, who had to pay for his bills from his English and Continental friends at an exorbitant rate, while it proved a boon to the exporter who secured, at times, 50 per cent over and above his merchandise profit by selling his exchange in the open market. This situation became so chaotic, especially in view of the large settlements which had to be made at that time, that the prominent banks in New York got together and fixed an arbitrary rate of \$5.00 for sterling and \$1.00 for five francs and four marks. This arrangement, of course, was only temporary and could not prove an effective means for the support of American exchange in London. After some preliminary conferences, a committee was appointed by the leading banks and trust companies, consisting of prominent foreign exchange men and bankers, to discuss relief, which finally led to the establishment of a \$100,000,000 gold fund, to which a number of prominent national banks, state banks and trust companies contributed a part. This gold fund was to be considered part of the Bank of England gold reserve and was to eliminate the hazard of gold shipments abroad; insurance premium on gold coin or bars at times being quoted at between two and three per cent. A subsequent arrangement between bankers on this side and the British government provided that deposits of gold could be made with the depositors of the Bank of England in Ottawa, the Canadian Minister of Finance, the equivalent of which at 4.90 would be made available in the depositor's London account immediately.

THE EFFECT OF THE GOLD POOL

It may readily be seen what an effect these measures had on the course of the foreign exchange rates. They imparted a feeling of security to the market, for the banker could at least rest assured that he could obtain the exchange at a reasonable figure by shipping gold without risk, providing always the latter could be obtained, which was very doubtful at times. This measure, however, coupled with the increasing exports of foodstuffs and cotton, made possible by the prompt measures taken by the United States Treasury Department in creating a war risk insurance bureau, soon brought exchange back to the normal level.

The end of 1914 saw exchange on London and Paris at practically normal, rates being quoted at 4.85½ and 5.16 respectively.

The rate on Germany, however, was quoted at $88\frac{1}{2}$, being a discount of about 8 per cent from par. This can, of course, be readily explained by the difficulty experienced by Germany in paying her debts in merchandise, due to the inability of her merchant marine to resume activities in face of the allied blockade, which proved one of the main factors of the downward trend of German exchange. The central empires, in this connection, are in about the same position as Russia whose foreign trade had practically ceased after the closing of the Dardenelles, and who, in order to establish at least a somewhat stable basis for exchange, had to resort to the two other alternatives—shipment of gold and raising of loans. These remedies, however, were largely offset by the tremendous importations of war materials into Russia, which by providing a continuous flow of exchange, had a very depressing influence on the market.

THE PHENOMENAL GROWTH IN OUR EXPORTS

While up to the period just mentioned, the bankers of this country had to exert their power in order to prevent American exchange from declining in London, the new year saw spectacular changes in the foreign financial situation of this country. Coupled with the large shipments mentioned above, the demand for war materials kept the exports of this country at a high mark, while imports were considerably less than in the same period during the previous year, which may be seen from the following figures:

EXPORTS FROM U. S. A.

	1915	1914
January	267,900,000	204,067,000
February	299,800,000	173,920,000
March	296,600,000	187,499,000
April	294,700,000	162,600,000
May	274,200,000	161,700,000
June	268,600,000	157,100,000

IMPORTS INTO U. S. A.

	1915	1914
January	122,148,000	154,743,000
February	125,123,000	148,045,000
March	158,040,000	182,555,000
April	160,600,000	173,800,000
May	142,300,000	164,300,000
June	157,700,000	157,500,000

EXCESS EXPORTS OVER IMPORTS

	1915	1914
January.....	145,700,000	49,324,000
February.....	174,600,000	28,875,000
March.....	136,000,000	4,944,000
April.....	134,170,000	11,209,000 x Imports
May.....	131,933,000	2,549,000 x “
June.....	110,856,000	457,000 x “

It can readily be seen from the above figures, that while in normal years the balance of trade in favor of the United States kept dwindling down during the first six months of the year, with a necessary stiffening of rates on Europe, the enormous imports of England, due to her added requirements on account of the war, built up a balance in favor of America which her diminishing exports could not overcome. It must, however, be said that in spite of this handicap the exchange rates on London were very steady. It must be remembered that the usual summer exodus of American tourists to Europe could not take place on account of the war. It is estimated that expenditures of Americans abroad during a year amounted, as a rule, to over \$300,000,000, most of which was settled through London banks, and this sum always contributed very largely towards offsetting an unfavorable balance of trade. England, and London especially, has always been the center of the foreign exchange market, exchange on the Continent being largely dealt in there, and it proved its sustaining influence even in these troubled times. Both sterling and francs maintained their position exceedingly well, but Italian liras declined very rapidly, being quoted at 5.46½ on February 1 and declining precipitately to 5.90 on March 1. In the second half of February sterling and francs, being unsupported, began to decline to 4.80 and 5.28 respectively.

No further adverse development took place in the market until the latter part of May when francs suddenly developed a pronounced weakness. Sterling began its downward course in the latter part of June and was quoted at 4.74, a discount of about 2 per cent. It continued at about that level until the beginning of August, when a very panicky drop took place, which carried sterling to the lowest point it ever sold at, 4.48½, showing a discount of about 8 per cent. This fall was mainly attributed to the fact that some houses in London, who had been largely interested in the importa-

tion of war material and commodities for the month of September, were trying to cover their forward commitments; when the enormous sums to be settled for in New York became known, the rates gave away completely. The decline in exchange, however, was only temporary as almost every one owning American securities sought to take advantage of the premium in London on New York exchange, amounting to about 7 per cent, and several millions of dollars of these were thrown on the market. This naturally had a rallying effect on the rates, which in the next few days rose again to 4.71, or a discount of $3\frac{1}{4}$ per cent.

CONDITIONS PRECEDENT TO THE ANGLO-FRENCH LOAN

This very disastrous fluctuation in sterling rates brought home to the British bankers the necessity of not only a more widely enforced policy of economy, but also the need of an adequate machinery which would act as a steadying factor in the foreign exchanges. There is no doubt that the rumor of an Anglo-French loan, which appeared in the market at that time, contributed very largely towards the sudden upward movement of sterling; before its realization, however, the selling of American securities in the financial centers of the Entente Allies continued, and large amounts found their way back to the United States. The selling, to a certain extent, came from English holders who wished to subscribe to the second British war loan, which was issued at that time. It must also be mentioned that at that time the French bankers entered the field as borrowers for the purpose of strengthening their exchange rate, which had fallen to 6.10. The so-called Rothschild loan, based upon a pledge of Pennsylvania $3\frac{3}{4}$ per cent and St. Paul Railway bonds netted \$43,000,000. The loan, floated by Brown Brothers & Co., based on collateral in the form of acceptances of Paris bankers, produced \$25,000,000; these sums were sufficient to steady francs, temporarily at least. They rallied to 5.79.

It must be borne in mind that not only the warring nations, but also the United States, were vitally interested in the plan to keep the rates at a certain level, and it was with this idea in mind that the English and French Commission arrived in New York in September, 1915. A credit had to be negotiated, for a moderate premium of 2 or 3 per cent would not, in the long run, induce the English investors to part with their American securities, and it was

at that time certain that few realized the need for selling from patriotic motives. The now famous Anglo-French loan of \$500,000,000 was negotiated on September 28, 1915. The plan contemplated the issue of \$500,000,000 five year 5 per cent bonds, which were a direct obligation of the British and French governments. These bonds were repayable at the end of five years, or convertible at the option of the holder into $4\frac{1}{2}$ per cent bonds of the two governments, repayable not earlier than fifteen and not later than twenty-five years, by both governments. The bonds which the underwriters received at 96, were dealt out to the public at 98, yielding about $5\frac{1}{2}$ per cent. A special clause stipulated that the proceeds were to be used exclusively for purchases in the United States. It provided sufficient funds to keep sterling at around $4.76 \frac{7}{16}$ and francs at an average of 5.90 for the next three and a half months. Contributions were to be paid in instalments as needed, the first payment being made on November 13; by the end of November 45 per cent, or almost half, had been paid to the National City Bank of New York as central depository; by January 3, three-quarters of the entire loan had been called for; the last payment was made on March 4, when the remaining 15 per cent were drawn against.

It is, of course, clear that this enormous amount of available funds gave to the market a steadiness it had not enjoyed since the beginning of hostilities. Instead of drawing on the purchaser of American goods in London or Paris, and selling his bill in the market, the exporters could go to New York where, after being visé by the representatives of the respective governments, his claim was promptly paid in United States dollars. This took an enormous amount of exchange out of the market, which factor was the main reason for the steadiness of sterling exchange, which in fact, as already mentioned, remained at around $4.76 \frac{7}{16}$ for about three months.

MOBILIZING SECURITIES TO SUPPORT EXCHANGE

It must, however, not be supposed that France and England remained idle during that period. Arrangements were made by England in December, 1915, under which a credit of \$50,000,000 was granted by a syndicate of American bankers, to a group of eight leading joint stock banks, for the facilitating of private transactions. This credit was secured by a deposit of British government

securities and was availed of in the form of acceptances bearing $4\frac{1}{2}$ per cent interest, and running six months. This provided payment for about \$50,000,000 of American exports, and contributed largely to keeping the market at the above mentioned level. Efforts were made as early as the summer of 1915, to mobilize the holding of French and English investors in American securities, in order to prepare for the eventual secured loan, which later events showed was inevitable if the allied governments wished to secure financial help in the United States, or have securities in hand which might be used as an immediate remedy should a fall in exchange become inevitable. The British government, after various appeals to the patriotism of its people, resorted to taxation as a means of compelling English investors to dispose of their securities. A special tax of two shillings per pound sterling was levied on all securities which were included in the mobilization plan, which meant an extra tax of 10 per cent. It may be said that even this tax did not induce all the large investors to part with their American securities, and considerable amounts are, undoubtedly, held in Europe. The purpose of the measure was to create an eventual offset to the enormous imports of the Entente nations in the above stated manner. The French government followed the example of her ally and made a special appeal to the patriotism of her citizens to lend it their foreign securities for one year, with an option of the government to retain them from year to year for three years. Negotiable receipts were given in exchange, dividends were paid as usual and a bonus of $\frac{1}{4}$ of per cent of the regular income was given, or, to illustrate, a 5 per cent bond would bring a return of $6\frac{1}{2}$ per cent.

THE LARGE IMPORTATIONS OF GOLD

When the proceeds of the Anglo-French loan were used up in payment for exports from this country, a temporary resort was had to selling of American securities. For the evident reason that a selling by private holders of American securities in the open market to America would have the very much desired effect of steadying the exchange situation, no obstacle was put in the way of such liquidation and it seemed rather to receive the full sanction of the government. The amounts realized from such sales, together with gold shipments of, however, no abnormal size, and the very ready ability of the agents of the British government to come to the sup-

port of the market, helped exchange over the critical period when deposits on the Anglo-French loan began to ebb in April of this year. A very interesting story may be learned by comparing the gold imports into the states during the first seven months of 1916.

<i>1916</i>	<i>Millions of Dollars</i>
January	15.080
February	6.016
March	9.776
April	6.121
May	17.321
June	122.734
July	62.107

It will be seen from these figures that, while funds were still available from the loan, gold imports were practically insignificant; when, however, other remedies were imperative for the steadying of exchange a sudden increase in gold importations took place, jumping from six millions in April to twenty-seven millions in May. In June the record-breaking gold imports contributed largely toward keeping the rates at the desired level, and in July, while not nearly reaching the dimensions of June, the imports of the precious metal were large enough to support the market. There is also no doubt that the rumors about a new fully secured loan to be floated in August for both the French and British governments had a reassuring effect on the market. These rumors developed into actuality when on August 1 the American Foreign Securities Company was organized with a capital \$100,000,000 paid in full. It was arranged with the government of the French republic to lend them the sum of \$100,000,000, for which it was to hold the obligation of the French government to repay the principal in three years, together with interest more than sufficient to cover the company's note issue. This loan is so far very interesting as it is the first officially sanctioned government loan for which the French republic had to put up collateral, and which netted them only \$94,500,000 in actual cash. The collateral used for this loan was collected under the mobilization scheme and consisted almost entirely of government securities of neutral countries, of about \$11,600,000 Suez Canal Company's shares and about \$4,700,000 American securities. An English loan of \$250,000,000 followed shortly afterwards, to bear 5 per cent and

running two years, also fully secured and offered by J. P. Morgan & Co., as syndicate managers. The list of securities which was made public is divided into three classes each aggregating \$100,000,000, the first consisting of American railroad, industrial and municipal securities, the second of bonds of the Dominion of Canada and the third of government bonds of neutral countries. These loans served the same purpose as all the others, and to such an extent has the American foreign exchange man become accustomed to the idea that the allied governments—unforeseen disasters excepted—will be able to keep up the rates, that the announcements of these relief measures hardly cause a ripple on the market.

OTHER EXPEDIENTS EMPLOYED

While in the foregoing we have reviewed the principal measures of the Entente nations to support their exchanges by exports and creation of credits, the very urgent appeal for economy, made finally in the form of embargoes on certain articles, both for import and export, should not remain unmentioned. The exportation of such articles was, of course, prohibited from national motives, but the embargoes on imports had certainly a rallying influence on the exchange as they lessened the supply of commercial bills in the market.

It may be mentioned, in connection with the above, that Russia and Italy, the other large economic factors on the Entente side, employed the same means as their Allies for the steadying of their exchange; their loans, however, mostly took the form of bank loans except the \$50,000,000 loan recently raised here by Russia, which embodies some very remarkable features, especially designed to assure the investor of a part in the profits which may be realized from a rise in rouble exchange.

Reports have been published here, that some of the most powerful German joint stock banks, aided by the Reichsbank, had endeavored in the beginning of this year to control the exchange market by fixing the buying and selling rate of marks each day and arranging that all bills sold were to be closely scrutinized, in order to prevent speculation. While such a measure might, with the necessary financial backing, steady the rate of exchange, it may be considered as useless and fallacious for the purpose of raising the rate at a time when payments in gold cannot be used in settlement

of foreign debts and when the export of merchandise is practically crippled. There is no doubt that the financial leaders of the great German banking institutions were fully aware of this.

In looking back over the financial history of the last two years, the main and the only measures which were taken by the various governments, may be summed up in three classes: shipping gold, selling foreign securities and paying debts with credit. How long this *modus operandi* can continue is a matter of conjecture. A pyramid of credit must have a sound foundation and, while there is little doubt that the British government will be able to finance her own and her Allies' purchases, signs are not wanting that credits to be secured for such purposes will find the neutral investor more and more exacting as time goes on and as the wealth destroyed in the present unprecedented struggle grows to gigantic proportions. The history of the loans to be raised from now until the end of the war for the purpose of steadying exchange, while not creating new problems will, without doubt, present some very interesting features.